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UNITED STATES SEED ACT ASSISTANCE STRATEGY UPDATE

**FOR
SLOVAKIA**



1994-1996

**Submitted by American Embassy Bratislava
Approved June 14, 1994**

This document updates the *U.S. Assistance Strategy for Slovakia, 1993-1995*, approved in June 1993. It incorporates political and economic developments since that date, as well as USAID experience in monitoring and evaluating the portfolio of SEED Act-financed activities in Slovakia for which it is accountable.

THE STATUS OF REFORMS

Political, Economic, and Social Overview

With the peaceful dissolution of the Czech and Slovak Federal Republic, Slovakia became an independent nation on January 1, 1993. The country was governed by the Movement for a Democratic Slovakia (HZDS) with support from the opposition SDL (Post-Communist) and SNS (Slovak Nationalist) Parties. Under a Constitution, adopted in September 1992, a parliamentary form of government was inaugurated with a Prime Minister (Vladimir Meciar) and President (Michal Kovac). A range of new institutions called for under the Constitution, including a Constitutional Court and a Central Bank, had to be established. Other, existing public sector agencies, the Ministry of Foreign Affairs, for example, assumed new and expanded responsibilities.

The Meciar administration failed to win a vote of no-confidence in a March 1994 Parliamentary debate. In the best tradition of parliamentary democracy in action, the Meciar Government was replaced by a broad coalition headed by Prime Minister Jozef Moravcik. Subsequently, Parliament voted to hold elections the end of September 1994.

The collapse of communist-era social guarantees and the failure of market mechanisms thus far to deliver prosperity exert a strong influence on public opinion. Over half the population believe their current standard of living compares unfavorably with that prior to 1989. On the other hand, a substantial and growing majority reject neutrality in favor of close ties with the West, in particular the European Community and NATO. In common with much of Central and Eastern Europe, the political landscape tends to be fragmented. There are an estimated 51 parties and political movements, of which eight are represented in Parliament.

While the Constitution provides for democratic institutions and the protection of human rights, a sizeable portion of the population with Hungarian background (about 560,000 out of 5.3 million) have expressed concern over their right to use traditional Hungarian names for their villages and women's last names. The Moravcik Government is pressing forward with legislation to meet these concerns. There are only 3,000 Slovak Jews remaining from a pre-war population of about 77,000. President Kovac as well as former Prime Minister Meciar publicly reassured the Jewish community that they are welcome. The present Government has taken a similar positive attitude. The 300,000 plus Romanies in Slovakia are protected by the Constitution from the most blatant forms of discrimination. There are, however, strongly held anti-Romany feelings among a large

portion of the citizenry.

Notwithstanding Constitutional guarantees of freedom of information and the right of expression, it is the breadth of views expressed in the media that is critical in a pluralistic society. The print media, by and large, meet the test of diversity. This cannot be said of national TV (both channels subject to Government control) and, to a lesser extent, national radio.

With regard to state support of the elderly, sick, unemployed, and disadvantaged, the current system is a patchwork of elements established under the Communist regime, combined with legislation from the former Federal Republic and post-independence period. The result--over forty overlapping social benefit schemes--can be described as costly, unfair (from the standpoint of both contributions and benefits), and inefficient. In an effort to reform and improve the system (and reduce expenditures in the National Budget) the Government combined pensions, sickness payments, health, and social care for the unemployed in one semi-autonomous agency. This has proved to be unworkable. Creation of a viable mechanism to deal with the social strains of economic transformation is an urgency, one that the Government, with donor assistance as appropriate, must tackle.

In short, Slovakia's post-independence experience is much what one would expect after two generations of unbending, authoritarian rule. As will be seen below, there are many noteworthy instances of democracy taking root. There are also cases where the USG and other Western donors can make a decisive contribution in this transition period.

THE ECONOMY

Macroeconomic Developments

As part of the former Czech and Slovak Federal Republic during the period 1989-92, Slovakia's economy showed:

- an overall contraction of GDP by about 22 percent. This was nearly average for the "Northern Tier" countries, but less severe than in the "Southern Tier" of Central Europe;
- a reduction in the rate of inflation to about 10 percent by 1992 (lowest in Central Europe), owing to a traditional policy of tight monetary control by the Federal central bank and low budget deficits. Thus the CSFR quickly contained the inflationary impulse of its comprehensive price reform of early 1991; and
- a rise in unemployment to about 12 percent by early 1993, much higher than in

the neighboring Czech Republic, but about the same or lower than in Hungary and Poland.

However, the economic cost of independence proved to be more than many Slovaks had anticipated. In 1992 Czech enterprises accounted for almost half of Slovakia's external trade. Disruption of these trade and payment relationships between Slovak and Czech enterprises was a major factor in Slovakia's poor economic performance in 1993.

As a consequence, it is estimated that Slovakia's real GDP fell by about 4.5 percent in 1993. This was among the larger declines in the CEE region, and indeed some other countries in the region experienced zero or positive growth for the year. PlanEcon calculates that about three-fourths of Slovakia's GDP drop can be explained by the fall in exports to the Czech Republic. Even without a similar shock it seems likely that, at best, Slovakia will experience zero growth in 1994. More conservative forecasters predict a further moderate decline. From the perspective of mid 1994, it therefore appears unlikely that a significant upturn will occur before 1995.

- In 1993, gross investment fell by 37 percent, while industrial output dropped by about 13 percent and construction by 25 percent. Private consumption was off by five percent, while in order to meet IMF budget targets, public consumption spending dropped by around 11 percent.
- Meanwhile, inflation accelerated. Preliminary estimates of annual retail price inflation place it at about 25 percent. About seven to eight percentage points of the total can be attributed to the introduction of a VAT in January 1993. Thus, the "core" inflation rate was closer to 17-18 percent and there were signs that it was accelerating during the last quarter of the year. Even so, the declining economy probably helped to keep prices somewhat in check despite a large government budget deficit. For 1994, the National Bank is placing the containment of inflation and stability of the foreign exchange rate as its highest policy objectives. The first quarter 1994 figures are encouraging.
- Unemployment rose during the year, exceeding 14 percent by December 1993. It is likely to rise through 1994.

Main Financial Developments

Upon achieving independence, the Government of Slovakia immediately plunged into a severe fiscal crisis. For the first three quarters of 1992 the monthly deficit was held to under 2 billion Slovak crowns (Sk). However a 47 percent surge in expenditures during the fourth quarter helped to drive the deficit up to 9 billion crowns for the month of December. The situation continued to worsen during the first quarter of 1993. As reported in last year's Strategy Statement, by April the Government was in the throes of a full-blown budget crisis, with the fiscal deficit running at about 13 percent of GDP.

While first quarter revenues were about the same as for the same period in 1992, expenditures were more than 50 percent higher. The crisis eased somewhat after mid-year, largely due to a surge in revenues led by the VAT and accompanied by sharp increases in collections of consumption levies and personal and corporate income taxes. Still, despite Ministry of Finance efforts to enforce austerity, expenditures continued to climb. Through September, cumulative spending was 43 percent higher than it had been a year earlier. Recent reports place the central government deficit for 1993 at 23 billion Sk (21 billion Sk, if the local governments' surpluses are included). According to National Bank of Slovakia (NBS) estimates, this represented 6.7 percent of GDP, compared to a target of 5 percent established under the IMF program. The fiscal deficit therefore continues to be a major economic concern and additional fiscal austerity is virtually certain to be a part of a follow-on IMF program.

By end-April 1993, Slovakia had managed to weather the foreign exchange crisis of the first quarter of 1993, which drained about \$200 million of the National Bank's foreign exchange reserves. By tightening domestic credit to commercial banks, and, in turn, from banks to enterprises, the NBS stabilized foreign exchange holdings during April. The NBS was able to stop the decline in its reserves without a substantial devaluation, although there was a modest devaluation combined with an import surcharge at midyear. Figures for 1993 are all preliminary, but it appears that Slovakia lost approximately \$250 million in net reserves during the year. By April 1994, however, the situation appeared to be under control. Official foreign exchange reserves had risen to \$500 million, despite the political uncertainties preceding the collapse of the former Government. At their current level official reserves are sufficient to purchase about 1.5 to 2 months of imports. While this is a slim margin, it is not especially threatening and certainly represents a vast improvement over the situation of a year ago. Meanwhile, total reserves for the entire banking system are estimated to be nearly \$2 billion. It is particularly significant that these unofficial reserves did not "flee" during the political uncertainty earlier this year.

After a modest surplus of approximately \$19 million in 1992, Slovakia's external current account dropped into a deficit of \$250 million in 1993. It is likely to remain in this range for several years. A large part of the change stemmed from a dramatic drop in net transfer payments; merchandise exports fell by nearly 13 percent, and imports by 14 percent in 1993.

Structural Transformation

Starting with the most heavily indebted state-owned enterprise sector in the CEE region at the end of the 1980s, the former Czech and Slovak Federal Republic made a relatively rapid shift toward a private, market economy. Indeed, in 1992, Slovak authorities claimed that they were ahead of the Czech Republic in that regard since they estimated the private sector share of GDP to be more than 32 percent, compared to only 20 percent in the Czech Republic (versus a 15 percent share in the combined Federation in 1991).

However, as already noted, the pace of privatization in Slovakia slowed markedly in 1993. By the end of the third quarter PlanEcon estimated that the private sector share of GDP had risen only marginally, to 37 percent. Due to a combination of World Bank conditionality (agreed to by the Meciar Government) and the new Government's priorities, privatization is again at center stage for 1994. The Government has determined to privatize all state-owned enterprises during the next two years. In the "first wave," under the old Federal Republic, 500 large, state-owned enterprises were privatized in addition to over 90% of small enterprises. Five hundred more SOEs are now to be added. Of those, 300 already have privatization plans and another 100 are to be liquidated. It is anticipated that approximately 300 companies will be sold through a combination of voucher and other methods.

Nevertheless, Slovakia's economy is still not as advanced as other Northern Tier countries in two important respects: (a) the reorientation of exports towards Western markets, and (b) the privatization of industry, particularly large scale enterprises (see Privatization and Economic Transformation below).

Secondary arrears (primarily the SOE's) totalled approximately \$2 to \$3 billion early in CY 1994, despite the implementation of a computerized arrears-clearing system. Even though legislation has been in effect for more than a year, there have been virtually no bankruptcy proceedings. Policy makers are concerned about the adverse impact of bankruptcies on otherwise healthy enterprises, on the banking system, on unemployment and political stability. A viable solution to the problem of financial arrearage is crucial to the achievement of several GOS reform goals and U.S. assistance objectives. This situation underscores the importance of taking a more holistic and integrative view of addressing constraints to more rapid transformation to a market economy.

SLOVAKIA'S STRATEGIC OBJECTIVES

The June 1992 electoral victory of the ruling HZDS Government was based largely on a desire for a more equal partnership with the Czech Republic in determining economic policy and, in particular, the pace of economic reform. In the economic policy arena, the primary Slovak objections to perceived Czech dominance in Federal policies were:

- privatization was being implemented too rapidly, especially through the "mass privatization" program pushed by then Federal Finance Minister Klaus. This seemed to foretell further crushing cutbacks of production and employment in the heavy industries and defense production factories which are disproportionately concentrated in Slovakia;
- many of the "adjustment policies" pursued by the Czech-dominated Federation--devaluation of the currency, and embargoes on exports of defense goods, for example -were perceived as stacked against the Slovak economy; and

- Federal Finance Minister Klaus refused to borrow on international capital markets, which could have helped to finance a milder decline in living standards, as in Hungary. This would have been feasible because of Czechoslovakia's low international debt and high credit standing in international financial markets.

Unfortunately, during its one and one half years in office, the Meciar Government was unable to articulate a more successful, alternative path in any of these areas. In its desire to attract outside capital, the Meciar Government switched from an emphasis on the voucher method to public tenders. However, relatively little was done to create a climate attractive to foreign investment. While it did reach policy accords with the IMF and IBRD, much energy was expended in crisis management and damage control during the initial period of state-building. As the year passed, there was growing awareness in the GOS that reorientation of its policies toward more realistic goals was in order. This was particularly true in the case of privatization and ultimately contributed to the first Government's fall from power.

Privatization and Economic Transformation

In mid-1992, the GOS determined its most urgent requirement was to attract foreign capital, something the voucher method of privatization was not designed to do. GOS policy, therefore, was to shift away from "mass privatization" through vouchers and to stress alternative modes of privatization. Essentially, the strategy was to entice foreign investors by advertising new tax holidays and by making public tenders or other competitive sales of companies.

Given an investment climate marked by uncertainty over currency stability and a lack of clear and transparent rules of the game, there was a dismal response by investors to enterprises offered for sale.

While investor interest in such direct sales has been limited, there have been sales of large, consumer-oriented companies, to foreign firms -- including a tobacco company, a brewery, and a chocolate factory. The U.S. is currently the third largest foreign investor (about \$50 million) after Germany and Austria, with K-Mart and Whirlpool being the largest U.S. investors. Pepsi Cola has confirmed plans to invest \$30 million in a distribution network.

The GOS has been widely criticized, both from within its ranks as well as from outside, for the slow pace of privatization. By late April 1993, key government officials and advisors appeared to favor increased emphasis of the voucher privatization method, with a "second wave" to be undertaken "soon." But, this did not happen. Meanwhile, to contribute towards the workout of bad debts and to the restructuring of problem companies which cannot be privatized, the GOS revised and enacted the Bankruptcy Law referred to above.

While it has yet to publicize a full, coherent and broad reform strategy, the interim

government that was installed in March 1994 appears eager to rectify some of the perceived shortcomings of the policy paradigm described above. The new Prime Minister, Jozef Moravcik, is on record as saying that it is *"the unambiguous goal of the new Slovak Government to speed up the process of economic transformation in a way society can bear."* The Government intends to take measures to develop the private sector. Special mention was made of the need to foster the development of small and medium enterprises. In particular, it has announced its intention to accelerate privatization and to reemphasize the voucher privatization method in order to do so. Indeed, the GOS is so bent upon this course that there may be some reason to be concerned about its ability to implement this abrupt policy reversal. The GOS has set a course to privatize a substantial proportion of assets before the September elections. Donor technical assistance is therefore important in attempting to ensure that economic and financial rationality play a proper role in the privatization process.

Macroeconomic Policy Program

In order to reestablish stability over the short and medium term, it was necessary for the GOS to reach agreement with the IMF on a macroeconomic stabilization program. This was accomplished in 1993. As part of the program, the GOS will need to:

- implement an exchange market policy which can be sustained without administrative restrictions (such as the new import surcharge and new import certification requirements) on importers' access to foreign exchange;
- agree on a budget deficit which will not completely crowd out the availability of bank credit to the enterprise sector; and
- continue to cut back budget expenditures to adjust to a declining revenue base. Social safety net expenditures have been reduced. For example, an income test has been introduced for child support payments and unemployment benefits cut back. Other expenditures (of which the most important are in the health sector and housing) are being reduced or responsibility shifted to local authorities.

In the realm of official state borrowing from foreign banks and institutional investors, Slovakia hopes to be able to join its Visegrad neighbors as the only countries in Central Europe deemed creditworthy enough to obtain sovereign syndicated loans and bonds on the international credit markets. Successful implementation of IMF and IBRD adjustment programs will help to reach this objective. The experience of the NBS in this regard is encouraging. In 1993 securities in the amount of \$240 million were successfully sold on the International Euro-Bond Capital Market in London by Nomura Securities.

External private capital can play a key role in restoring economic growth, in accelerating economic transformation, and in achieving technology transfer and upgrading. Reasonable political stability (or at least a somewhat predictable political climate) and

sound fiscal and monetary policies (rather than gimmicks such as tax holidays and special investor incentives) form the foundations of a good investment climate and are essential to the successful re-establishment of long term growth and transformation.

There are indications that the new Government seems to appreciate the importance of these factors, and the monetary policy stance of the National Bank of Slovakia appears also to be geared toward fostering an enabling environment for domestic saving and investment as well as for attracting foreign capital. The outcome of the September election is, therefore, likely to be a key determining factor in Slovakia's economic success over the next several years.

THE STRUCTURE OF DEMOCRACY

Slovakia has succeeded in establishing the constitutional foundation on which a democratic system rests. While instances of abuse have occurred and state influence is dominant, the democratic structure is in place. A constitutional and regulatory system that provides basic rights and freedoms--free and fair elections, freedom of speech, religion and assembly, equality before the law--and a division of powers and system of checks and balances that can protect these freedoms through an independent legislature and judiciary and a free press exist. Significant work remains in strengthening the independence of judges, the civil service, and mass media.

Plurality of Institutions

With basic freedoms secured, the network of institutions and political organizations, which act within the political structure, must now develop their capacity and ability to use these freedoms effectively and responsibly. The institutions are both governmental and non-governmental: the legislative, executive, and judiciary branches of government as well as the political parties, the media, the educational system, and the network of professional, ethnic, or regional organizations that animate and participate in a democratic political process. Some institutions and professions are progressing or adapting more rapidly than others--the judiciary, for instance, appears to be making strides in rethinking its role in a democratic system as well as lobbying the Parliament for the additional legislative and regulatory guarantees which it needs to secure its independence. The media, on the other hand, has difficulty questioning the authority of the government.

Democratic Culture

In order to benefit from a system that grants and protects the rights and freedoms typical of a Western democracy, citizens must understand and appreciate the opportunities which a pluralistic society affords them. This requires understanding both at an intellectual and attitudinal level. This is the area in which progress in Slovakia lags most. It manifests

itself not only in the passivity and frustration displayed by the general population, but also in the fashion with which many a political leader distances himself from his own constituency. U.S. assistance can help put systems in place which will inform and remind the adult population what its rights and responsibilities are and instill a greater understanding of these concepts in the coming generations.

The democratic assistance strategy focuses primarily on strengthening the non-governmental institutions which help secure a democratic process. There is great interest and receptivity to this assistance. The non-governmental institutions are also, for the most part, more dynamic and more committed to reaching out to the general population. They offer a practical, grass-roots mechanism to instill an appreciation of democracy among the wider population, a task which may well take a generation. Efforts might include communication between political representatives and constituents, efforts of local communities to assess their own problems and take control of their own future, civic groups' programs to explain political processes and reforms to a mistrustful electorate, and to provide balanced analyses of key issues for laymen.

There are several sectors in which the current structure can be reformed or improved to protect from excessive governmental interference. These sectors include media, judiciary, civil service, local government. Specific areas requiring attention include: licensing of media outlets, privatization of the state printing press and distribution network; a judicial code that protects the independence of judges; civil service reform; redistributing powers and revenue raising authorities between national and local level of government. In some cases, non-governmental organizations have developed to prepare the needed legislation or regulations and to lobby the government for the required changes. For example, the Association of Slovak Judges and the Club of Mayors are becoming effective advocates for their respective interests. The biggest obstacle to change until recently was a lack of political will to pass the required reforms. While many are hopeful that their particular area of interest will receive the attention of the broad coalition in the coming six months, the nature of the governing coalition that emerges in October 1994 will be decisive.

PROGRESS TOWARD MEETING OBJECTIVES

There have been a number of events in the last year that reinforce the belief democracy is taking root in Slovakia.

- The smooth transition from the Meciar to Moravcik governments is an excellent example of parliamentary democracy in action. Both the interim coalition and the opposition quickly agreed on the necessity and timing of new elections.
- The newly formed Association of Slovak Judges, dedicated to strengthening judicial independence, reinforces the principle of separation of power. Most of the Association's

views on judicial discipline and responsibilities have been incorporated in a judicial code now being considered by the Minister of Justice and Parliament.

- The receptivity by Parliament to assistance from the Frost Committee, and resulting improvements in that institution's research and information service, is a positive development. It is noteworthy that Parliament has asked for assistance in revising Parliament's rules and procedures, most of which are a holdover from the Communist era.
- There has been discernable progress in decentralizing decision making. A Club of Mayors, representing 32 of the Country's largest municipalities, has developed into one of the most democratic and reform-minded organizations in the country. The agenda which they are pressing in Parliament is to empower state and local governments by allowing these entities to raise revenue. The Club of Mayors' objectives are directly related to privatization, social sector restructuring, and democratization, all of which address the core US interests in Slovakia.
- Diversity in the print media was bolstered by the Moravcik Government's decision to privatize--rather than stop publication--of a newspaper representing the views of the former Premier's Movement for a Democratic Slovakia (HZDS) Party.
- Recent opinion polls indicate there has been a marked reduction in political apathy and an upsurge in confidence and interest in the political process.
- There has been a substantial increase in the number (now almost 500) and viability of non-governmental organizations. In addition, an umbrella association has been established to represent NGO interests in Parliament. The NGO's are broadly based throughout the country; for the most part, they are in the fields of democracy building and civic participation, environment, and humanitarian assistance.
- With regard to the economy, the Government is desirous of revitalizing the privatization process and restoring investor confidence. The goal is, *"to create the necessary conditions for the broadest possible integration of the Slovak economy in the European and world economic structure."* To this end, a 16 part Manifesto has been approved by Parliament. As noted above, the Government restated its intention to follow through on undertakings with the IMF and IBRD on privatization, foreign exchange availability, meeting budget deficit targets, and cutting social safety net expenditures. Where it is feasible to do so, the Government commitments will be buttressed by USAID technical assistance tied to IBRD structural lending, as is the case with the planned EFSAL.

In assessing progress, however, it is difficult to escape the conclusion that in the post-independence period the Government could have been more aggressive in attracting foreign investment. Also, along with most other governments in the region, the Slovak leadership has not adequately explained to its citizens the necessity and consequences--at least in the short run--

of economic transformation.

UPDATE OF STRATEGY AND PLAN

The strategy for SEED Act assistance to Slovakia remains basically unchanged from that enunciated a year ago. However, the goal of rooting Slovakia firmly in the Western economic and political community has been clarified and refined as follows:

- 1. Assist in the transformation to a private market economy, including privatization of state-owned assets, restructuring of major industry, and development of the financial sector.***
- 2. Assist in the social sector restructuring, which is the inevitable accompaniment of major political and economic change.***
- 3. Assist in strengthening pluralism and the decentralization of decision-making.***

The First Objective - Transformation to a Private Market Economy

U.S. assistance will concentrate on the privatization of all state-owned assets and restructuring directly related to this objective. Initiatives which merit our fullest support include the following:

- Provide assistance to the Ministry of Privatization and National Property Fund in the second wave of large scale privatization involving more than 500 companies. U.S. support will concentrate on the privatization of all state-owned assets and restructuring directly related to this objective.
- Help expand the liquidity and improve the efficiency of the financial sector, including the restructuring of the General Credit Bank's portfolio of poor performing loans.
- Encourage small business development by (a) upgrading the financial and marketing skills of selected enterprises, and (b) by addressing the policy and regulatory obstacles limiting small business growth.
- Help overcome a major obstacle to Slovakia competing in world markets by assisting in privatization and reform of the electrical power sector and by improving nuclear safety, particularly the obsolete Russian type reactors.
- Work with the GOS and other donors to assist in establishing the Slovak Environmental Revolving Investment Fund (SERIF) as an effective instrument for generating capital. The widespread deterioration in urban infrastructure and the environment has had a negative impact on the economy, local government, and health status of the population.

- Make a significant contribution in developing a critical mass of Slovak professionals trained in market economics and management.
- Assist the GOS in drafting the legislation leading to privatizing health care, both facilities and services.
- Provide the expertise leading to the development of a rational land market, including land titling and the reduction of subsidies and price controls. The objective is the timely divestiture of state-owned land and the restructuring of long term agricultural sector debt.

The specific objective in each of the sectors mentioned above is to transfer assets and decision-making responsibility from public to private hands as quickly as sound management allows. To this end, we will continue to collaborate closely with the IBRD, EBRD, and EC PHARE.

The Second Objective - Social Sector Restructuring

Cash transfers to individuals and households amount to 25% of GDP. At the same time, there is a growing recognition that a strategy for transformation to a market economy cannot ignore Slovakia's destitute, sick, and unemployed. The multilateral institutions are increasingly sensitive to this concern. For example, the IBRD's recently approved Economic Recovery Loan requires incremental changes in the social benefits system. U.S. technical assistance has a key role to play in a number of specific areas.

In view of the foregoing, the second major objective for U.S. assistance is to support the Government in the critical area of social sector restructuring. In the short term, this translates to helping the GOS establish a system that is viable, targeted, and manageable. U.S. assistance will support the following initiatives:

- Assist in establishing a stable and predictable health care financing system which is incentive and performance based. Accordingly, we will help strengthen the management information and payment systems of the National Health Insurance Fund.
- Elaborate a pilot activity in the Detva/Hrinova area of middle Slovakia (one of the hardest hit regions of the country), where USAID is engaged in a major defense conversion project. The project would test a range of interventions designed to create jobs and to minimize the hardships connected with widespread regional unemployment. The activity could include retraining and counseling for former employees of the plants as well as privatization of factory housing, a vocational school and a health center.
- Provide assistance to the Ministry of Labor, Social Affairs and Family to

help reduce inequities and inefficiencies in the system of housing allowances. Currently such payments are based on the size of the rental unit rather than ability to pay. A formula-based system bringing rents up to market levels, and targeting allowances to the needy, would facilitate the sale of municipal housing stocks, increase mobility, and reduce the claim of such allowances on the State budget.

The Third Objective - Pluralism and Democracy

The third fundamental objective of U.S. assistance is to firmly ground Slovakia within the Western tradition of pluralism, individual freedom, and democracy. As noted above, the constitutional safeguards already are in place. Now the task is to work with the various institutions to encourage and assist them to develop their full capacity.

An essential, related element in carrying out the U.S. democracy strategy is to educate the citizenry on the rights and opportunities which a pluralistic society involves. Accordingly, we propose the following initiatives:

- Utilizing the Embassy Democracy Network and Small Grants Program, we will pay particular attention to strengthening and expanding non-governmental organizations. A vibrant NGO community, particularly outside of Bratislava, will be critical in decentralizing power and deepening democratic attitudes and values.
- We will encourage a truly multi-voiced media. This will involve efforts to privatize the state press and distribution network, broaden the licensing of radio and TV, and expand the training of journalists.
- Empowering mayors and other locally elected officials--including the decentralization of revenue raising authorities--is critical. We will do everything possible to further this process through TA and training, and through speeding up the divestiture of municipally-owned housing stocks and land. USAID technical assistance was instrumental in drafting a Condominium Law enacted in 1993. It will be a key tool to carry out this portion of the strategy.
- Building on successful efforts to establish an Association of Judges, we will continue to support an independent judiciary, in fact as well as in theory. The next step is official enactment of a judicial code formalizing judicial rights and responsibilities. Commercial law and legal education are related fields where our support could make an impact.
- In the event it is feasible to do so, we will support badly needed civil service reform and training.
- We will continue to assist the second phase of a teacher training/curriculum reform project in two school districts. If successful, it will be the basis for

a national effort to introduce a "Spirit of Democracy" in primary and secondary classrooms.

MANAGEMENT CONCERNS

Last year's U.S. Assistance Strategy for Slovakia highlighted the desirability of having relatively fewer contractors/grantees (each with a larger scope) and fewer, better-prioritized activities under the strained-to-the-limit monitoring purview of the understaffed USAID office. The problem is even more acute today and manifests itself particularly in the environment sector. In addition, for sectors such as energy and health, where the magnitude of the assistance is significant, project-funded, in-country contractors or grantees will be necessary to ensure proper management and coordination. We seek Washington support in reducing/eliminating funding for activities which do not meet the criteria of (a) responsiveness to the objectives described above, and (b) demonstrable impact.

CONCLUSION

The U.S. assistance strategy for Slovakia is focused on those objectives--privatization/economic restructuring, social sector restructuring, and pluralism and decentralized decision making--where U.S. assistance can have a significant impact and where the U.S. has a comparative advantage vis a vis other donors.

As noted in last year's Strategy Statement, phase out of assistance to Slovakia can be expected to be slower than projected for the Czech Republic, Hungary and Poland, where implementation of political and economic reforms appear to be more advanced. Based on our assessment of Slovakia's needs and the pace of change, we assume there is a critical role for the U.S. Government to play here until the end of the decade.

At this stage in its history, less than two years since independence, Slovakia is poised to become a solid and respected member of the Western community of nations. The country's most significant assets are a resourceful and literate populace, one that is increasingly receptive to Western ideas; an entrepreneurial spirit alive and well in many sectors nationwide; and an advantageous location with respect to international trade and commerce. With the right mix of political will and sound policies on the part of the GOS, combined with appropriate and timely support from the donors, this outcome can be assured.

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PRIORITY BRATISLAVA

AIDEU FOR AMBASSADOR AND AIDREP

E.O. 12356: N/A

TAGS:

SUBJECT: RESULTS OF REVIEW OF U.S. ASSISTANCE STRATEGY
FOR SLOVAK REPUBLIC

THIS IS A JOINT STATE/USAID CABLE

1. SUMMARY: THE 1994 UPDATE OF THE U.S. ASSISTANCE STRATEGY FOR THE SLOVAK REPUBLIC WAS REVIEWED ON JUNE 9, 1994 AND APPROVED SUBJECT TO THE DECISIONS CITED BELOW. THE COUNTRY TEAM'S STRATEGY UPDATE WAS WELL RECEIVED BY USAID/W FOR ITS ANALYTICAL CONTENT AS WELL AS THE AIDREP'S PRESENTATION AT THE INTER-AGENCY REVIEW. REPRESENTATIVES FROM ENI, COMMERCE, DOL, DOJ, FTC, STATE, TREASURY, AND USIA WERE PRESENT AT THE MEETING WHICH WAS CHAIRED BY DAA/ENI CARLOS PASCUAL. THE FOLLOWING PARAS SUMMARIZE THE PROGRAM AND POLICY CONCLUSIONS OF THE REVIEW. END SUMMARY.

2. GENERAL PROGRAM CONCLUSIONS

PROGRAM BUDGET: THE STRATEGY UPDATE EXERCISE EMPHASIZED THE NEED TO FOCUS AND CONCENTRATE SEED RESOURCES AT THE COUNTRY LEVEL AND THAT THE AIDREP SHOULD CONTINUE TO REVIEW THE PROGRAM WITH THE PURPOSE OF FINE-TUNING THE PORTFOLIO TO THE EXTENT THAT THE ADJUSTMENTS ARE CONSISTENT WITH THE COUNTRY TEAM'S PRIORITIES, FUNDING LEVELS, AND STAFFING. THE INTER-AGENCY REVIEW CONCLUDED

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THAT ENI WILL NOT FUND ASSISTANCE IN NATIONAL CIVIL SERVICE REFORM. HOWEVER, HIGH PRIORITY WAS GIVEN TO ALLOCATING FY 1995 RESOURCES FOR THE PUBLIC ADMINISTRATION PROJECT (180-0019.07) TO ASSIST SLOVAK ENTITIES ON ADMINISTRATION AND DECENTRALIZATION OF DECISION-MAKING PROCESSES ON A LOCAL LEVEL. PRIVATIZATION AND FINANCIAL SECTOR REFORM WERE REAFFIRMED AS TOP BUDGETARY PRIORITIES FOR THE SLOVAK REPUBLIC. IN THE AREA OF SOCIAL SECTOR REFORM, THE COUNTRY TEAM WAS COMMENDED FOR EFFECTIVELY UTILIZING SCARCE RESOURCES BY CONCENTRATING THE IMPACT OF SEVERAL JOB CREATION AND SOCIAL SERVICE PROGRAMS IN A FEW REGIONS TO ENHANCE PROSPECTS FOR TANGIBLE IMPACT.

3. ECONOMIC RESTRUCTURING

A. PRIVATIZATION: THE COUNTRY STRATEGY UPDATE PAPER (CSUP) STATES THAT USG ASSISTANCE WILL CONCENTRATE ON THE PRIVATIZATION OF ALL STATE-OWNED ASSETS BY THE END OF 1995. DURING THE STRATEGY REVIEW, THE AIDREP ELABORATED THAT, AT THE NATIONAL LEVEL, THE USG IS PROVIDING NEEDED ASSISTANCE TO THE SLOVAK GOVERNMENT FOR THE PREPARATION OF THE SECOND WAVE OF PRIVATIZATION. THE AIDREP STATED THAT USAID IS ALREADY HELPING SLOVAK GOVERNMENT (GOS) TO DEVELOP THE IMPLEMENTATION PLAN FOR THE SECOND WAVE OF PRIVATIZATION. TECHNICAL ASSISTANCE WILL BE EXPANDED TO SUPPORT THE GOS PUBLIC EDUCATION EFFORT TO EXPLAIN AND GARNER SUPPORT FOR BOTH THE VOUCHER AND DIRECT SALES ASPECTS OF PRIVATIZATION. AT THE ENTERPRISE LEVEL, THE STRATEGY UPDATE REVIEW CONCLUDED THAT DIRECT USAID ASSISTANCE IN THE PRIVATIZATION OF EACH AND EVERY ENTERPRISE MAY NOT BE FEASIBLE GIVEN USAID'S LIMITED RESOURCES. TO HAVE SPECIFIC IMPACT, THE USG PRIVATIZATION AND FINANCIAL SECTOR ACTIVITIES SHOULD BE MORE FOCUSED AND PRIORITIZED. IT WAS AGREED THAT ENI/PER/EP WILL WORK CLOSELY WITH OAR BRATISLAVA IN COORDINATING USAID'S APPROACH TO THESE ACTIVITIES. IN LIGHT OF THE AMBITIOUS PRIVATIZATION TARGETS, THE STRATEGY REVIEW REQUESTED THAT SPECIFIC BENCHMARKS BE ESTABLISHED TO HELP THE POST TRACK AND MONITOR ITS PRIVATIZATION ACTIVITIES AND TO USE THE BENCHMARKS AS A DIALOGUE WITH THE SLOVAK COUNTERPARTS.

B. FINANCIAL SECTOR: DURING THE STRATEGY UPDATE REVIEW, FINANCIAL SECTOR PRIVATIZATION AND COMPREHENSIVE REFORM WAS MENTIONED AS A KEY INGREDIENT FOR PRIVATE SECTOR DEVELOPMENT. SPECIFICALLY, RESTRUCTURING OF THE SLOVAK GENERAL CREDIT BANK'S POOR PERFORMING LOANS WAS VIEWED AS AN IMPORTANT ELEMENT TO REVITALIZATION. IN GENERAL, THE AIDREP NOTED THE NEED FOR MORE TECHNICAL ASSISTANCE TO HELP BANKS WITH PORTFOLIO RESTRUCTURING TO FREE UP CREDIT FOR NEW ENTERPRISES. PORTFOLIO RESTRUCTURING INVOLVES

WORKING CLOSELY WITH HIGHLY INDEBTED ENTERPRISES TO MAKE DECISIONS ABOUT LIQUIDATION, RESTRUCTURING, PRIVATIZATION, ETC. THE AIDREP STATED THAT USAID WILL WORK WITH TREASURY, THE WORLD BANK, AND OTHERS TO FORMULATE A PLAN TO ASSIST THE DEVELOPMENT OF THE FINANCIAL SECTOR. THE COUNTRY TEAM WAS ASKED TO ANALYZE THE CONSEQUENCES IF INDEBTEDNESS CONTINUES TO STAGNATE THE SLOVAK ECONOMY, AND OUTLINE THE POTENTIAL SCENARIO WHICH MAY RESULT FROM THE UPCOMING ELECTIONS.

C. ENERGY/NUCLEAR SAFETY: STATE/PM/NE/NSSC DESCRIBED THE UNSAFE CONDITIONS AT THE VVER 440/230 NUCLEAR PLANTS IN THE SLOVAK REPUBLIC, PARTICULARLY UNITS ONE AND TWO OF THE BOHUNICE NUCLEAR PLANT, AND LOOKED TO USAID'S BREADTH OF PROGRAMS TO SHUT DOWN THE NUCLEAR REACTORS. PENDING SUCH SHUTDOWN, LIMITED NEAR TERM RISK REDUCTION MEASURES WOULD BE REQUIRED; BOTH OPERATIONAL SAFETY AND REGULATORY ASSISTANCE WILL BE PART OF FUTURE WORK WITH SLOVAKIA. THE AIDREP NOTED THE AMBASSADOR'S STRONG INTEREST IN THE NUCLEAR SAFETY ISSUE AND THAT THE BROADER ISSUES CONTINUE TO BE ADDRESSED IN REGIONAL G-7 CONTEXT. DURING THE REVIEW, ENI'S DIVISION CHIEF ON ENERGY AND INFRASTRUCTURE REVIEWED USAID'S WORK WITH THE WORLD BANK AND EBRD IN PURSUING ACTIVITIES TO PROMOTE ENERGY RESTRUCTURING AND PRIVATIZATION, IMPROVE ENERGY EFFICIENCY, AND PROMOTE EFFECTIVE NUCLEAR SAFETY REGULATION AND THE SAFE OPERATION OF THE BOHUNICE NUCLEAR POWER PLANT. ENI/EEUD/EI PREPARED A SUMMARY OF THE CURRENT AND PLANNED ENERGY PROGRAM. THE DAA REAFFIRMED USAID'S CONTINUING EMPHASIS ON ENERGY AS PART OF THE ECONOMIC RESTRUCTURING STRATEGY AND THE HIGH PRIORITY OF NUCLEAR SAFETY ISSUES.

4. SOCIAL SECTOR RESTRUCTURING

A. DEFENSE CONVERSION: THE STRATEGY UPDATE SUGGESTS THAT A SOCIAL SECTOR RESTRUCTURING PILOT ACTIVITY COULD COMPLEMENT AN USAID DEFENSE CONVERSION ACTIVITY CURRENTLY UNDERWAY IN DETVA AND HRINOVA. THE PILOT ACTIVITY COULD PROVIDE JOB CREATION, JOB TRAINING, AND OTHER ACTIVITIES TO TWO COMMUNITIES SEVERELY AFFECTED BY LOSS OF JOBS FROM A MAJOR EMPLOYER. IN THE STRATEGY UPDATE REVIEW, THE AIDREP DISCUSSED WAYS OF TAPPING INTO ALREADY EXISTING RESOURCES, SUCH AS THE SLOVAK-AMERICAN ENTERPRISE FUND AND HOUSING ACTIVITIES, TO IMPLEMENT THE PILOT ACTIVITY. THE STRATEGY UPDATE REVIEW CONCURRED THAT THE PILOT ACTIVITY SHOULD BE LINKED WITH THE HOUSING, HEALTH, SLOVAK-AMERICAN ENTERPRISE FUND, AND OTHER RELEVANT ACTIVITIES. THE RESULTS OF THE PILOT ACTIVITY CAN BE APPLIED TO SIMILAR COMMUNITIES, ON A NATIONAL LEVEL.

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B. HEALTHCARE REFORM: THE AIDREP EMPHASIZED HEALTHCARE REFORM AS A PRIMARY AREA OF ASSISTANCE. THE OBJECTIVE OF USAID ASSISTANCE IS TO STABILIZE THE HEALTHCARE SYSTEM IN THE SHORT-TERM IN A WAY THAT WILL SUPPORT LONG-TERM SYSTEMIC CHANGE. ASSISTANCE WILL BE TARGETED AT THE POLICY AND OPERATIONAL LEVELS. TO ACHIEVE THESE OBJECTIVES, ASSISTANCE COULD FOCUS ON ESTABLISHING A PREDICTABLE AND STABLE FLOW OF FUNDS INTO THE HEALTHCARE SECTOR, IMPROVING MANAGEMENT OF HEALTHCARE INSTITUTIONS, ENCOURAGING COMPETITION AND CONSUMER CHOICE ON THE BASIS OF COST AND QUALITY OF HEALTHCARE, AND HELPING TO ATTRACT CAPITAL THROUGH A NEW MIX OF PUBLIC AND PRIVATE OWNERSHIP OF HEALTHCARE ENTITIES. THE STRATEGY UPDATE REVIEW CONCLUDED THAT ACTIVITIES CONSIDERED FOR RESTRUCTURING SLOVAKIA'S SOCIAL SECTOR, I.E, THE PILOT PROJECT, SHOULD INCORPORATE RESOURCES AND ACTIVITIES THAT ARE PLANNED FOR HEALTHCARE REFORM.

5. DEMOCRACY/PLURALISM

A. POLITICAL AND SOCIAL PROCESS: THE REVIEW MEETING CONSIDERED THE ADVANTAGES AND DISADVANTAGES OF PROVIDING ELECTIONS ASSISTANCE FOR POLITICAL PARTIES PRIOR TO THE UPCOMING ELECTIONS. THE STRATEGY REVIEW RECOMMENDED THAT U.S. ASSISTANCE ON POLITICAL PROCESS ISSUES SHOULD FOCUS ON LONG-TERM POLITICAL PARTY DEVELOPMENT RATHER THAN ELECTIONS ASSISTANCE. FUNDING HAS BEEN ALLOCATED FOR FY 1994 AND FY 1995 FOR POLITICAL PARTY DEVELOPMENT.

B. CIVIL SERVICE REFORM: THE STRATEGY REVIEW CONCLUDED THAT CIVIL SERVICE REFORM AT THE NATIONAL LEVEL IS NOT A PRIORITY FOR USG ASSISTANCE TO THE SLOVAK REPUBLIC AT THIS TIME. GIVEN LIMITED RESOURCES AND THE NEED TO MAKE CHOICES ON HOW WE FOCUS OUR ASSISTANCE, IT WAS AGREED TO TARGET PUBLIC ADMINISTRATION ASSISTANCE AT THE LOCAL LEVEL.

6. RATHER THAN SPEND ADDITIONAL TIME EDITING THE COUNTRY STRATEGY TO INCORPORATE THE ABOVE COMMENTS, THIS CABLE WILL BE ADDED AS A PREFACE TO THE COUNTRY STRATEGY WHEN IT IS REPRODUCED. ANY NECESSARY CHANGES IN THE BUDGET, HOWEVER, SHOULD BE MADE PRIOR TO REPRODUCING THE STRATEGY.

7. THIS CABLE HAS BEEN CLEARED IN DRAFT BY USAID/ENI TECHNICAL OFFICES (GROHS, BURNS, HYMAN, ICHORD, CLELAND, LANDY), STATE/EE/EUR (GIBBONS), USIA (SWENSON), COMMERCE (MAWREY), TREASURY (WHITAKER AND ALTHEIM), DOL (MERRILL), FTC (RICHARDS), DOJ (SPENCER), AND STATE/PM/NE/NSSC (DOBRIN). YY

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